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TAX·FEATURES

Gramm-Rudman-Hollings Measure Leaves Major Questions Unanswered

New Watchdog Committee Bolsters TF Oversight Of Federal Budget Action

The Tax Foundation has established a Shadow Committee on the Federal Budget to scrutinize official budget and fiscal reports of the Federal government and provide reliable information on them in clear and concise English. The Washington-based tax watchdog organization has assembled a team of experts to conduct this ongoing audit of the Federal budget and its economic implications. The group is patterned on the Shadow Open Market Committee, the existing private sector effort to assess the Federal Reserve's conduct of monetary policy.

Objective Scrutiny Needed

Budget and fiscal policy reports from any Administration and any Congress are by their very nature political documents. The Administration has a built-in bias to understate the budget dilemma, and Congress has a similar bias driving it to attack the Administration's budget and press for changes.

The Congressional Budget Office was set up in 1974 as a check on any Administration's budget claims. While CBO has done some good work, it also has added more confusion to the budget process. The result is widespread uncertainty over such seemingly simple matters as the proper "baseline" (starting point) for measuring proposed changes in spending and Federal revenues. Budget cuts claimed on paper fail to materialize as baselines are juggled at the whim of the estimators on Capitol Hill and in the White House.

In setting up the Shadow Committee, Tax Foundation's Trustees sought to ensure that an independent agency could exist that might work to keep the baselines and estimates honest and accurate.

This is particularly important now because of the Gramm-Rudman-Hollings budget initiative which calls for 10 percent across-the-board spending cuts whenever deficit reduction targets for the next five years are not met. This will intensify the need for such a private-sector effort to sort out what is—and what isn't—real deficit reduction.

Plain English Needed

Another major aspect of the current budget debate is

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"A bad idea whose time has come."

The above words of one of its principal sponsors, Senator Warren Rudman (R-NH), may be the most apt description of the Gramm-Rudman-Hollings (GRH) balanced budget initiative. What started out as one of our perennial after-the-fact protests about the size of the national debt is now the law of the land, mandating a staged reduction in the Federal budget deficit to zero by 1991. Despite widespread dissatisfaction with the measure, it was approved by comfortable margins in both the House and Senate. Many Congressmen held their noses while voting for it but approved it nevertheless to show the state of frustration and desperation over our budget/debt situation. The Administration had reservations about the impact of GRH, too, particularly on defense spending. But the President committed early to the concept and went along with changes insisted on by the House.

The table below shows the budget deficit-reduction targets by fiscal year.

Like past legislative efforts to pose a balanced budget, GRH prescribes no way to get there in terms of substantive changes in specific expenditure programs. It does not even mention the possibility of tax action except for an oblique reference to the corporate minimum tax. It does carve out and safeguard certain

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Federal Deficit Projections Under Current Policy and Gramm-Rudman-Hollings

Fiscal Years 1986-1991
($bils)

	1986	1987	1988	1989	1990	1991
(A) Current Services Budget as of August 30, 1985	242.6	253.1	255.9	243.8	237.9	
(B) Mid-Session Review of Fiscal '86 Budget	177.8	139.3	99.8	53.6	17.7	
(C) "Realistic" Current Policy Budget, January 1, 1986 (average of A + B)	210	196	178	149	128	100
(D) G-R-H Deficit Targets	172	144	108	72	36	0
(E) Potential Mandated Budget Cuts[1]	12[2]	52	70	77	92	100

[1]For fiscal 1987-1990, the deficit targets must be missed by more than $10 billion for sequestration to be ordered.
[2]Limited by formula to $11.7 billion in fiscal 1986 only.
Sources: Office of Management and Budget, Tax Foundation computations.

(GRAMM-RUDMAN, from page 1)

expenditures—interest on the national debt, social security and most other entitlement programs—from automatic cutbacks. As these constitute a significant portion of the overall budget, GRH has been called another empty gesture on budget control.

But unlike the Byrd amendment of 1978 and other past efforts at budget balance, GRH does provide for a mandatory "sequestration" procedure, whereby if deficit targets are not being met by the prescribed time in the budget cycle, automatic percentage reduction to achieve that target is ordered with a 50-50 split of the overall reduction between defense and non-defense areas of the budget subject to the sequestration order. This is the general rule with some special rules applying to fiscal 1986, cost-of-living adjustments on Federal pensions, health programs, unemployment compensation, student loans and some other areas. Also, the whole process could be short-circuited by recession or forecast of recession.

The sequestration procedure is the "club" which GRH sponsors believe will force the Administration and Congress to get serious on budget control. The optimists claim that the existence of the "club" should be enough to ensure deficit target compliance ahead of the mandatory cutback procedure and that the actual sequestration order won't be necessary.

"One major certainty about GRH. It will change radically the way budget decisions are made."

Pessimists point to the failure of existing budget legislation and timetables even to agree on what the budget dimensions should be, let alone prevent a spiraling deficit. They claim that GRH will overlay budget policy with a thicket of new procedures that result more in lengthy new disputes rather than effective enforcement. Besides, it may be declared unconstitutional by giving too much power to the Executive Branch or to the General Accounting Office (GAO).

Legitimate major concerns about GRH relate both to the objective and procedures. First, of course, there is the sheer *potential* magnitude of the task as outlined in the table. Potential is emphasized, but it's so difficult to tell where we are even starting from in terms of baseline budget deficits. The current service budget of last August—which assumes no policy changes at all—is probably too pessimistic for the future. The mid-year session review of OMB, also as of August 1985, is too optimistic because it assumes full implementation of budget cuts under the First Concurrent Resolution for fiscal 1986 in the defense area and much deeper cuts in the non-defense area which Congress is resisting. Also, the cost of the current farm bill and farm credit bailout are not reflected. As of yearend 1985, the most realistic budget deficit projection would approximate an average of the two.

Much, of course, depends on the growth of the economy itself. If it slows significantly but does not go into a recognized recession, the mandated budget cuts could be far, far larger than portrayed in the table. And in any event, the job will be complicated further by putting so much of the budget entitlement programs off limits to sequestration. Approximately $428 billion or 44 percent of the fiscal '86 budget request would be off limits entirely and more, particularly in the health area, would be subject to only small cuts. This means that when the real crunch comes for fiscal 1987, Congress and the President could be seeking to cut (or raise new taxes) equivalent to at least $50 billion, or about 10 percent of the pertinent base. In an economy with some inflation this poses a formidable but by no means impossible task.

One major certainty about GRH. It will change radically the way budget decisions are made—in the bunching of mandatory time-dated actions, the forcing of critical forecasts of inherently murky numbers, and the perhaps casual disregard of the impact on the economy of major budget shifts. And that will make the task of those trying to track the course of budget policy much tougher. The need for private sector watch-dogging of the figures will be even greater.

Tax Foundation Working Paper of December 20, 1985, gives more complete analysis of Gramm-Rudman-Hollings. See below for details on ordering this and other Tax Foundation Working Papers.

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FEDERAL TAX POLICY MEMO

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JANUARY 1986

The House Tax Bill

What can be said about the 1,363-page House version of tax reform in one tenth of one percent of the space? For one thing, they did have the decency to take "simplification" out of the title. This was an oft-stated objective of the popular flat tax and other proposals of recent times and found prominent mention in the Treasury Report of November 1984, "Tax Reform for Fairness, Simplicity and Economic Growth."

Simplicity has not vanished entirely in the House bill. Many individuals would find it easier to compute their tax liability, particularly if they are among the estimated six and a half-million low-income filers to be dropped from rolls entirely or among the additional millions who would be encouraged to switch from itemizing deductions to the standard deduction. But for those who would have to compute the new alternative minimum tax and for virtually all businesses—large or small, economic beneficiary or loser from tax change—tax matters would be more complicated and careful tax planning even more important. The potential transition problems alone are staggering, especially in areas such as capital recovery with the abandonment of the Accelerated Cost Recovery System (ACRS) and the investment credit and the institution of a new depreciation system with minor indexing attached.

Some more complexity was inevitable as the purer ideas of tax reformers were ground through the legislative mill. Some of it also reflected the particular way this piece of legislation was handled—the leisurely pace of post-Treasury Report massaging by the Administration and the extensive trading of interests within the Ways and Means Committee.

The dimmer the prospects for simplification, the less interest the general public seemed to take in tax reform. By summer 1985, public sentiment had identified tax reform as just another Washington dance, and the President was having great difficulty in generating support for the program. In the end, the House bill was adopted mainly because of the commitment of the House leadership and an extraordinary effort by the President to rescue the measure from ambush by House Republicans.

Aside from lost simplification and last-minute political histrionics, there is a degree of continuity in the major themes of tax reform as set out in the Treasury Report of 1984 and as evolved in the House bill. These are:

(I.) Rate reduction and strengthening of tax-free allowances.

(II.) Limited base broadering in the individual sector.

(III.) Shift of tax burdens to the business sector.

(IV.) Overall revenue neutrality, at least for the next five years.

Another major theme was added to the process later on: the alternative minimum tax.

A few comments on how these played out:

(I.) Rate Reduction and Allowance Increases

The individual tax rate formula of Treasury I—15-25-35 percent—gathered moral authority of its own over the past year. Even with the additional 38 percent top rate, the House bill came closer to it than many thought possible, particularly after retaining full deduction for state/local taxes. The slightly asymmetrical 15-25-35-38 individual rate schedule proposed in the House measure must stand as a singular accomplishment whatever the eventual fate of reform.

To be sure, there is less incentive value in the way the Ways and Means Committee constructed its rates. Marginal rates after the first 15 percent cut in at *significantly lower levels of income* than under the Administration program. For joint returns, for example, the House marginal rate is 25 percent over $22,500, 35 percent over $43,000, and 38 percent over $100,000. This compares with the Administration's 25 percent over $29,000 and 35 percent over $70,000. As a result, married taxpayers currently with $43,000-$49,000 in taxable income actually would face a two point increase in their marginal rate, from 33 percent to 35 percent, even though their overall effective rate of tax might fall. Approximately 9 percent of all joint returns would be affected by this notch, which would also be a problem for single and head-of-household returns as well. These lower thresholds of tax were deemed necessary because of more limited base broadening and the more decided tilt to the lower income groups under the House measure.

The importance of a potential twelve point or greater reduction in the top marginal rate should not be overlooked. This could have a significant impact on work and savings incentives—more so perhaps than the twenty point reduction from 70 percent to 50 percent in 1981. The latter's impact was obscured by the previous dual treatment of income—earned income taxed at a maximum of 50 percent and so-called "unearned" or investment income at 70 percent. A maximum rate of tax in the 35 to 38 percent range could prove effective in diminishing interest in uneconomic tax shelter investments—more effective in this respect probably than the complicated minimum tax proposal in the House bill. Until rates are reduced sufficiently so that the combination of Federal and state marginal rates are well below 50 percent, we will not get a true test of the "market" approach to encouraging productive investment as opposed to tax-motivated shelter investments.

One important drawback to encouraging investment overall, however, is the House bill's increase in the effective capital gains rate to a maximum of 22 percent, compared to 20 percent currently, and the retention of long-term capital gains as a preference income item subject to a stiffer alternative minimum tax. Higher capital gains taxes without any indexing of

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basis would run counter to the thrust of marginal rate cuts on ordinary income.

As for allowances, Treasury I got the ball rolling on a large increase in the personal exemption and some increase in the standard deduction (or zero bracket amount). The House went along with this thrust but raised the standard deduction more (to $4,800 for joint return in 1987) and limited the proposed $2,000 personal exemption to non-itemizers. Those itemizing deductions, in effect, would have their personal exemption set at $1,500, although inflation indexing would raise the levels for both itemizers and non-itemizers in the future.

This split personal exemption saves some revenue while allowing more relief to flow to the lowest income groups, who, more typically, are non-itemizers. In conjunction with light treatment of most fringe benefits, the overall result of the House measure, not surprisingly, would be to rearrange the benefit of tax reduction down the income scale. This is shown in the table below comparing the distribution of tax change by income group for the Administration's program of May 1985 and under the House bill.

Percentage Change in Income Tax Liability By Income Class (1987 Level)

Income Class ($000)	Administration Program	House Bill
Less than 10	-35.5	-76.0
10 - 15	-22.8	-23.4
15 - 20	-13.5	
20 - 30	- 8.7	- 9.9
30 - 40	- 6.6	- 9.0
40 - 50		- 8.7
50 - 75	- 4.2	- 7.4
75 -100		- 5.7
100-200	- 4.1	- 7.3
200 and above	-10.7	- 5.9
TOTAL	- 7.0	- 9.0

Sources: "The President's Tax Proposals for Fairness, Simplicity and Economic Growth," May 1985 and Ways and Means Committee Report on H.R. 3838, December 7, 1985.

The House bill clearly is more generous to the lowest income groups, slightly more generous to middle-income groups, and "takes away" some benefit from the over $200,000 group relative to the Administration program, mainly as a result of the proposed alternative minimum tax and slight increase in the maximum capital gains tax. The House bill's overall reduction for individuals is also marginally greater than under the Administration program.

With the shuffling of rates and allowances, the House bill still would not produce any dramatic shift in relative tax burdens. The overall structure would remain "progressive," in some respects, even a little more progressive. The average tax rate of those in the below $10,000 income class would be cut very sharply, but in dollar terms they don't pay very much anyway under present law.

One of the least controversial thrusts of current tax reform has been to cut low-income taxpayers off the rolls. The Administration program emphasized this objective, and the House bill certainly obliged with higher tax-free allowances and an increased earned-income credit. Approximately six and a half million returns, or about 6 percent of the individual return base, would be dropped out of taxpaying status by the measure.

Average Income Tax Liability and Tax Rate, Present Law and Committee Bill, by Income Class, 1987

Income Class ($000)	Tax Liability		Average Tax Rate	
	Present Law	Committee Bill	Present Law	Committee Bill
0 - 10	$ 68	$ 16	1.4	0.3
10 - 20	886	678	5.8	4.4
20 - 30	2,168	1,954	8.3	7.5
30 - 40	3,346	3,045	9.3	8.5
40 - 50	5,100	4,658	11.0	10.1
50 - 75	8,166	7,563	13.2	12.2
75 - 100	14,223	13,407	16.0	15.1
100 - 200	28,245	26,196	19.8	18.4
Over 200	136,714	128,711	23.5	22.1
All	$ 3,210	$ 2,919	11.3	10.5

Source: Ways and Means Committee Report on H.R. 3838, December 7, 1985.

A consensus assumption is that nobody below the poverty level should be subject to Federal income tax, and it is hard to argue with that sentiment. In the House bill, however, the tax threshold for joint and head-of-household returns is well above the estimated poverty level—up to 57 percent higher if the earned-income credit is included. The poverty level itself, of course, is an arbitrary statistic, not reflecting in-kind welfare benefits or actual living conditions.

An older school of thought held that all citizens with income should pay at least something toward support of the Federal government through its principal revenue source to give them some stake in how public expenditures were made. This has been swept under the rug in the rush to embrace a populist reform plan.

II. Base Broadening

Expansion of the individual income tax base by cutting out or reducing special exclusions, deductions, and credits has been the tax reformers' dream for decades. But the nirvana of true neutrality continues to elude us. Base broadening is very limited in the House bill.

The original Treasury I program opted to retain some popular deductions—mortgage interest in particular—and this raised pressure on both the Administration and Congress to keep more. The big issue, of course, was state/local taxes. It was said that the Ways and Means Committee kept the state/local deduction to gain votes for the overall reform package. But the Administration never really made a good case for eliminating the deduction in the first place. Its argument that high-tax states were being subsidized at the expense of low-tax states through the Federal deduction was not convincing when individual taxpayers had relatively little choice in the matter.

Most of the attempts to tax fringe benefits also went down to defeat. Administration flip-flops on which way to tax employer-provided medical insurance premiums set up that proposal for a knockout by labor interests. Taxation of group life insurance premiums (under $50,000 in coverage) was also dropped. The House did, however, extend tax to all unemployment benefits and made some very significant changes in retirement income provisions, mostly to increase the tax bite. (The latter area is treated by a special Tax Foundation working

paper, "Tax Treatment of Retirement Savings—Success Under Attack.") The only other significant additions to the regular individual tax base in dollar terms were eliminations of the two-earner deduction and income averaging.

Overall, by five years out in fiscal 1990 (when most all provisions would be fully phased in), the House measure would pick up a "reported" $38 billion in additional revenue through changes in special exclusions, deductions, and credits (not including the proposed $500 floor on itemized deductions which is considered less of a tax break for itemizers than a base broadening). This $38 billion would amount to about 7 percent of estimated total individual income tax receipts in fiscal 1990 assuming the rate reductions were in place, too. This is about 38 percent of the amount of similar base broadening under the Administration program for the same year. If the state/local tax deduction is not reflected in this comparison, the House base broadening would amount to 63 percent of the Administration program.

III. Business Provisions

For the business community the good news list about the House bill is pretty short. It's the corporate rate reduction from a top rate of 46 percent to 36 percent on income above $75,000—still three points higher than the Administration proposal—and similar cuts for small corporations with income below $75,000. The bad news goes on quite a bit longer and culminates in $139 billion in net additional corporate income taxes over the 1986-1990 period. This is about $20 billion more than reported for the Administration's May 1985 program. According to the Joint Committee on Taxation, the House measure would raise the share of corporate income tax receipts from 16 percent of total income tax receipts, currently, to 23 percent in fiscal 1988 and 1989, settling back a bit afterward.

How we got to such a sizeable proposed increase in business taxes only four years after the big cuts under the Economic Recovery Tax Act of 1981 (ERTA) makes an interesting story, which we don't have space to detail here. But the key developments were:

(1) The Treasury I report broke the mold of the leading congressional tax reform proposals—Bradley-Gephardt and Kemp-Kasten—both of which aimed at revenue neutrality *within* the individual sector and *within* the corporate sector. Treasury I framers claimed that its higher tax burden on business was not deliberate in itself, but was the result of a rigorous application of tax "neutrality" among industries, better measurement of income, and keeping the top corporate and individual rates close together. Maybe so, but the increase in business taxes did happen to facilitate a net reduction in individual taxes, especially the generous $2,000 personal exemption, while keeping the overall package revenue neutral on paper. The cat was out of the bag.

(2) The long-term shrinkage in the corporate income tax as a share of total Federal revenues or income tax revenues was accelerated by ERTA in fiscal 1982-1984. Also a spate of "studies" were calling attention to the alleged low or negative effective rates of tax of some major corporations and business sectors. Much of the material in these studies was not relevant for public policy purposes, but they attached an undeniable stigma to the whole corporate sector in terms of perceived fairness of the system. The Ways and Means Committee report on H.R. 3838 stresses the need "to restore the traditional balance of the income tax between individuals and corporations" as a justification for net tax increases on business and to restrict "the ability of corporations to eliminate their tax liability," a rationale for the tougher corporate minimum tax. Interestingly, a good part of the decline in the corporate tax share attributed to the ERTA capital recovery liberalization would have reversed itself naturally in future years as the benefit of accelerated depreciation was used up. Congress, however, was not willing to wait.

(3) The real split in the business community obviously helped facilitate some business-bashing in the bill. Those favoring lower corporate rates as a top priority generally supported the measure. The opposition, particularly among the capital-intensive industries, was louder but not effective in trying to turn the central thrust of reform away from business tax hikes. Small business interests, which generally are well represented on the Hill, were also split. But as the Ways and Means Committee markup went on, small business opposition was neutralized by a series of concessions exempting small business from much of the base-broadening tax increases—and complicating tax planning in the process, of course.

As for the economic results, should the thrust of H.R. 3838 be enacted into law, we would be taking a bit of a gamble. We would be betting that the lower tax rates in both individual and business tax sectors, combined with some evening of tax burdens among economic sectors, would encourage economic efficiency and growth, despite the increased cost of capital in the industrial sector.

On the plus side, the corporate rate reduction is important, to be sure. Even if it doesn't reach the full thirteen point drop proposed by the Administration, a top rate of no more than 36 percent would help stimulate market investment, whether labor or capital intensive, as after-tax returns are increased. The incentive effect on investment would be enhanced by the tandem reduction in both the individual and corporate rates, which we have not had on the same order of magnitude in any of the previous post-World War II tax reduction measures. When the prospective contribution of individual investors is considered, a net tax increase on the corporate sector might be viewed as somewhat less threatening for overall capital formation and growth.

But threatening it still is, particularly in the capital recovery area. The stretchout of depreciation under the House bill is very significant for long-lived assets. With a four percent inflation rate, the present value of depreciation allowances for industrial machinery is 21 percent less than under ACRS and for commercial real estate, 40 percent less. This, in combination with the loss of the investment credit, certainly presents a sea change in capital recovery policy compared to the prior trend. Even a low rate of tax can have adverse impact on plant and equipment investment without an effective capital recovery system. And this point is sure to be raised in the Senate consideration particularly as it relates to international competition.

One provision the House did not adopt was the depreciation recapture scheme proposed by the Administration in its May 1985 program. This was very unpopular, not only among

those who would be directly affected but also as a precedent for other types of investment that might be hit with retroactive tax hikes.

The House bill did pick up many of the other tax increases in the Administration program affecting a wide range of domestic and foreign business enterprise. It modified some, offered small business exemptions to some, and added a few of its own. The stated objective was to reduce tax "subsidies" to particular industries or through particular accounting methods.

At this point, there is no way to assess with any accuracy the overall impact of so many changes in tax treatment—except that they would increase costs of doing business in many respects and would condition both market behavior and the revenue estimates attached to tax reform.

IV. Revenue Neutrality and the Alternative Minimum Tax

In the major 1969 and 1976 tax bills, measures of reform were eased through with a dose of tax relief mostly for low- and middle-income individuals. In the context of our multi-billion budget deficits today, a major tax reform bill probably cannot be written without a firm commitment to no net loss in revenue. This target did serve as a form of glue keeping the process from disintegrating. While some business representatives argued that economic growth from rate reduction should be reflected more in the revenue estimates to lessen the need for tax increases elsewhere, there is not yet agreement on how to measure that growth for purposes of legislative policy decisions. The Ways and Means Committee fell back on the Joint Committee on Taxation's traditional method of revenue estimating and achieved a paper balance, at least over the five-year forecasting period.

All sorts of things could, and, in fact, are very likely to, go wrong with such projections as the economy adapts to extensive tax change. By tightening depreciation treatment drastically now, either the House bill or the Administration program would become decidedly unbalanced in the future beyond fiscal 1990 as short-term revenue gains peter'out. With its indexing proposals, mostly ignored by the House, the Administration program could result in even larger future revenue drains depending on the future course of inflation.

In any event, in the House bill, the constraint of revenue neutrality, in conjunction with other political objectives, was to seal a large business tax increase and encourage the adoption of a stiffer alternative minimum tax on both individuals and the corporate sector. By adding more preference items to the base and by greatly diminishing the differential between the regular tax rate and the alternative minimum tax rate, the House, in effect, would create a dual income tax structure—one that millions of taxpayers would have to contend with whether or not they would end up with minimum tax liability.

Outlook

One known result of the House bill is the confusion it is causing already for a lot of taxpayers. Many of the effective dates of base-broadening provisions were set for January 1, 1986, or even earlier. While most assume the House and Senate will agree to move effective dates forward, there's no guarantee of that, particularly with regard to incentive type provisions such as the investment credit. Meanwhile, in the press of haggling over the tax bill and the budget reconciliation measure, a number of tax credit provisions, affecting numerous activities, from research and development to solar energy, were allowed to expire on December 31st. Some of these would be continued under the House bill and some wouldn't. But, as of this writing, the House and Senate have not agreed on how to extend them even temporarily.

There is some indication that uncertainties about the fate and timing of capital recovery provisions are having a negative effect on business capital spending plans for 1986. If so, this will tend to reinforce the President's call to retain "basic tax incentives for American industry" in the Senate consideration. What that would mean specifically in terms of changes in the capital recovery provisions from H.R. 3838 isn't known.

The President also has stated that he would veto any reform bill that did not include a full $2,000 personal exemption, at least for those in low- and middle-income brackets, and maximum rates no higher than in his proposal. It's not clear whether he was referring to both the corporate and individual rates or just an individual top rate of 35 percent. The latter, it would seem, is the bottom line requirement for Administration approval of a reform measure.

These stated Presidential requirements don't appear to give the Senate much wiggle room and still allow them to come up with a revenue neutral package. However, it could be done by exchanging even lower tax thresholds for the 35 percent top rate and by a restrictive interpretation of which middle-income brackets are eligible for the full $2,000 personal exemption. Another way, of course, to meet the President's requirements would be to repeal some of the state/local tax deduction. But the Senate does not seem likely to bite that bullet after the House took the state/local tax deduction off the table.

A more critical threat to the tax reform effort in the Senate is a collision with Gramm-Rudman-Hollings mandated budget deficit reductions. If these turn into tax increase proposals, as many assume they will, a revenue-neutral tax reform bill could become irrelevant and unravel. It should escape nobody's attention, of course, that in H.R. 3838 we have legislative language for literally hundreds of tax increases that could be lifted directly from a reform package and be put in a deficit reduction package without the rate reductions. (Query: how many of these could be considered "revenue enhancers"?) The Gramm-Rudman-Hollings legislation itself does direct Congress to come up with a corporate alternative minimum tax to help reduce the deficit, and that's front and center in H.R. 3838.

Alternatively, Congress could turn to a new source of revenue, such as an oil import fee—once again being talked about—or even a business transfer tax. In the meantime, the Senate Finance Committee will plod on with new hearings and a markup aimed at revenue-neutral tax reform, probably along the lines of the House bill. Even without public clamor for it, tax reform does have a momentum of its own. By mid-Spring, probably by April 15 tax day, we should know if that momentum is strong enough to carry it through the Congress.

Treasury's James Baker, III Cited for Public Service

Significant tax reform *can* happen," Secretary of the Treasury James A. Baker, III, told Tax Foundation's Annual Dinner December 4th. Secretary Baker addressed Tax Foundation Trustees and other leading corporate executives and media representatives who had gathered at the Waldorf-Astoria Hotel in New York for the Foundation's 48th Annual Dinner. The Treasury Secretary also received the Foundation's Distinguished Public Service Award for 1985 from Hans W. Wanders, President of the Wachovia Corporation and newly elected Chairman of the Foundation's Board. Secretary Baker outlined the Administration's tax reform goals, which he summed up as "fairness, simplicity, and economic growth."

Describing the fundamentals behind the proposals as "market-oriented populism," Secretary Baker listed six key elements of the President's plan:

- "First, we must lower personal rates."
- "Second, we must broaden the tax base through the reduction of preferences and shelters."
- "Third, we must not place the tax burden on low-income people."
- "Fourth, we seek equitable treatment of different businesses."
- "Fifth, we want to achieve lower corporate rates in a manner consistent with an overall interest in capital formation and growth."
- "Sixth, the reform must be revenue neutral."

Calling both the Democratic tax bill, which passed the House December 3, and the Republican substitute, which was voted down, "flawed in several respects," the Secretary noted "they represent an important start toward meaningful tax reform."

THE FRONT BURNER

By Robert C. Brown
President
Tax Foundation, Incorporated

"Shadow Budget Committee"

This year sees the birth of a new entity at the Tax Foundation—the Shadow Committee on the Federal Budget. Designed to keep an eye on the conduct of the Federal budget debate, the Shadow Committee has only one public—the American taxpayer.

Any budget—every budget—is a political document. The White House designs the budget to make the incumbent President look good, and look even better, as they say, "in the out years." The Congressional Budget Committees respond but keep in mind the interests of incumbent Representatives and Senators. Most often, those interests are all too short term—re-election the next time out. The Congressional Budget Office has struggled heroically, first under Alice Rivlin and now under Rudy Penner, to remain nonpartisan. To its credit, CBO has largely succeeded here. With 535 elected Members of Congress as its boss, the CBO has been less successful in its pursuit of accurate statements of the budget condition.

Where this leaves the general public is asking the perennial question: "Who will guard the guards?" When public officials prove incapable of putting the public interest before their own political objectives, who will point this out?

In the area of national budget policy, the Tax Foundation's Trustees have come up with an answer: The Shadow Committee on the Federal Budget. Perhaps without fully realizing it, the Foundation has been evolving toward such a vehicle for a number of years. As spending outpaced taxation as a headline grabber, our analysts found themselves confronting budget issues with increased frequency. Given the available staff and resources, something had to be done if the Foundation's traditional excellence in objective analysis and reporting was to be sustained. The answer, again, was the Shadow Committee.

The Trustees were fortunate, indeed, in finding public citizens of the character and expertise of those who have agreed to serve as charter committee members. Leif H. Olsen has repeatedly shown his ability to track and interpret public economic issues as Chairman of Citibank's Economic Policy Committee. Harry F. Byrd, Jr., former Senator from Virginia and longtime Trustee of the Tax Foundation, has a vast store of wisdom garnered over 17 years in the United States Senate, including lengthy service on the Senate Finance Committee. W. Bowman Cutter brings extensive experience in the Office of Management and Budget and now in the private sector with a major CPA firm in Washington. Al Ullman, with nearly a quarter of a century in the Congress, including many years as member and later chairman of the Ways and Means and Budget Committees during a number of crucial debates, is a vital contributor to the team. Finally, Allen Schick, professor in the School of Public Affairs at the University of Maryland, and formerly a budget analyst with the Congressional Research Service, probably has as comprehensive a grasp of the Federal budget process as anyone working in this complex and sophisticated field.

The Committee now exists. Its operation has begun. Washington will dictate the agenda. Evolving circumstances will ultimately shape the Committee's understanding of itself and of the statements and reports it issues. As the distinguished members launch their effort, we wish them a successful voyage over the rough water of the budget debate.

"When public officials prove incapable of putting the public interest before their own political objectives, who will point this out?"

"Another major aspect of the current budget debate is that budgetary documents are written in complex bureaucratese and provide little or no understandable guidance for the American public."

TF's 37th Conference Probes U.S. Tax and Deficit Issues

"The Tax Agenda—Level Field or Minefield?" served as the theme of Tax Foundation's 37th National Conference in New York December 4th. Speakers probed a wide range of issues dealing with the economy, tax policy, and the impact of trade and budget deficits on tax reform.

Norman Robertson, Senior Vice President and Chief Economist of Mellon Bank, keynoted the meeting with an overview of the economy for 1986. He predicted that the economy would continue to expand in 1986, but at a slower rate—"2-2½ percent or less by the second half of 1986," he said.

Don Fullerton, Deputy Assistant Secretary for Tax Analysis of the Treasury Department, and John S. Nolan of Miller and Chevalier, a Washington law firm, discussed "Business Tax Policy—Forging a New Consensus?" The Business Transfer Tax was evaluated by Ernest S. Christian, Jr., a partner in the Washington law firm of Patton, Boggs & Blow, and James P. Bryant, Vice President and Director of Corporate Taxes for J.C. Penney Company, Inc.

W. Michael Blumenthal, Chairman of the Board and Chief Executive Officer of Burroughs Corporation and former Secretary of the Treasury, was the featured speaker at the conference luncheon.

The former Treasury Secretary expressed five reservations about the current tax proposals:

- The tax debate diverts national attention from the budget deficit.
- The tax bills worsen both the undervaluation of the dollar and the lack of competitiveness of U.S. industry.
- They are pro-consumption and anti-savings and investment.
- They are anti-investment in research and development.
- They may be revenue neutral, but even so, "we need more revenue."

"There simply is no credible solution to the budget problem without new taxes," Blumenthal charged. "And the tax bills evade this issue altogether."

He called for "new taxes—new sources of revenue. That is the issue which we must face."

[The full text of Blumenthal's speech appears in the fall issue of Tax Foundation's *Fiscal Policy Forum*. Copies of this issue are available from the Foundation's Office of Public Information.]

The afternoon session of the conference looked at the "Two Deficits"—budget and trade—and whether these would overshadow tax reform. Rudolph G. Penner, Director of the Congressional Budget Office, discussed the budget deficit; and Clarence J. Brown, Deputy Secretary, U.S. Department of Commerce, discussed the trade deficit.

More than 350 business executives, media representatives, government officials, professors and students of economics and political science attended the day-long conference at the Waldorf-Astoria Hotel. The sessions were followed by the Tax Foundation's 48th Annual Dinner at which Secretary of the Treasury James A. Baker, III, received the Foundation's Distinguished Public Service Award for 1985. (See accompanying article, this issue.)

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that budgetary documents are written in complex bureaucratese and provide little or no understandable guidance for the American public. The reports, because they are virtually unintelligible to the general tax-paying citizen, carry less and less credibility and command less and less attention—inside or outside of Washington.

Tax Foundation's Role

Since the days of the New Deal, the Tax Foundation has earned a reputation for the accuracy and credibility of its ongoing program of research and public education on the tax and fiscal activities of all levels of government. The Trustees felt it was the logical organization to assemble a team of experts, to raise from nongovernmental sources the funds needed to carry on the project, and to sponsor a continuing audit of the Federal budget and its economic implications.

Continuous Oversight

As a continuing private-sector effort to track and analyze the development of the Federal budget for each fiscal year, the Committee will focus on:

1) The reasonableness and internal consistency of underlying economic assumptions.

2) The believability and achievability of proposed budget changes in terms of authorizations, expenditures, receipts and changes in government credit programs, whether on- or off-budget.

3) Analysis of the same points under (2) above for the Administration's initial budget presentation, any substantial revisions including midyear review, the Congressional Budget Office response to the Administration budget, the House-Senate Concurrent Resolution on the budget, and other reports as necessary.

4) The implications of alternative budget approaches, actions and inaction.

5) Publication of the results of such analyses in a manner designed to ensure widespread distribution and attention, including press conferences to which Washington-based national media would be invited.

The Committee

Leif H. Olsen, Chairman, Economic Policy Committee of Citibank, N.A. (1977-1985), will chair the Shadow Committee on the Federal Budget. Serving with him will be:

- The Honorable Harry F. Byrd, Jr., United States Senator from Virginia (1965-1982); member, Committee on Finance (1969-1982).
- W. Bowman Cutter, Partner, Coopers & Lybrand; Executive Associate Director for Budget, Office of Management and Budget (1977-1981).
- Allen Schick, Professor, School of Public Affairs, The University of Maryland; former Senior Specialist, Congressional Research Service.
- The Honorable Al Ullman, United States Representative from Oregon (1957-1981); chairman, House Budget Committee (1974); chairman, Committee on Ways and Means (1975-1981).

The Shadow Committee on the Federal Budget will hold its first session February 5 in Washington, at which time it will examine and respond to the President's Budget Message.

Further details are available from Tax Foundation.